

Attachment 7 to Annex I to the Agreement

Activity Description for the Component for the Reactivation of the Economy
Through Agricultural Credit and Technologies Activity

I. Executive Summary

The component for the Reactivation of the Economy through Agricultural Credit and Technologies Activity (the "REACT Activity") has as its principal objective the reactivation of the economy through assistance to micro, small and medium entrepreneurs and farmers. To contribute to this objective, the REACT Activity will focus on the following areas:

- To resolve the constraint among small and medium agricultural producers and businesses for medium-term credit to replace productive infrastructure damaged or lost during Hurricane Mitch, REACT will promote the *expansion of medium-term credit* available to these producers.
- To contribute to the *recovery and reactivation of small and micro-enterprise*, the REACT Activity will assist in the recapitalization of mature micro-finance institutions, permitting these organizations to restructure loans for, and expand business and financial services to, small and micro businesses in secondary cities affected by Mitch.
- To contribute to *the recovery and reactivation of small and medium farms* the REACT Activity will provide extension services to these target groups in areas such as improved agricultural technologies, value-added processing, and alternative crops.
- Finally, in order to ensure that *policies are in place to promote economic reactivation*, the REACT Activity will intensify technical assistance in key policy areas related to hurricane reconstruction efforts.

II. Problem Statement

Hurricane Mitch devastated Honduras in late October of 1998, wreaking havoc across a broad swath of the country. Crops and the seed for new plantings were swept away or damaged by flooding and torrential rains. Productive infrastructure was severely damaged and the once vigorous economy suffered huge losses. The capacity to pay current loans disappeared with the lost harvest, while the capacity to earn future income disappeared when floods washed away livestock, seed, flood barriers, fences, and farm equipment and buildings – the productive infrastructure needed to permit land, capital and labor to produce income.

It is estimated that the total economic loss due to Mitch exceeds \$4 billion. Agricultural production, which prior to Mitch represented 24% of GDP, 37% of employment, and the majority of exports, was especially stricken, with losses of nearly \$1 billion. Banana, plantain, shrimp, melon, livestock, basic grain, and coffee production suffered significant losses. As a result, agricultural exports for 1999 and 2000 are expected to decline, aggravating poverty and unemployment. Financial sector intermediaries were also affected, as default rates soared with the collapse of many businesses, which in turn further increased unemployment. Across the board, the sector of the population most affected by the economic destruction caused by Mitch was the poor majority.

To reactivate the economy, damaged farms and businesses must be recapitalized, seed and animal stocks replenished, and productive infrastructure repaired or replaced. In addition, technical assistance must be provided to small and medium farmers and micro, small and medium entrepreneurs to assist them in increasing production, income and employment. Assistance will be provided to recapitalize the cooperatives, credit unions, and other institutions that provide these target groups with the agricultural credit and technology services.

III. Description of Activities/Implementation Plan

The REACT Activity will rely on a number of key activities which shall be jointly planned and developed with public and private sector partners. Initial and subsequent allocations of REACT Activity funds to each partner to implement activities will be based upon performance. The criteria used to determine performance will include, but are not limited to, the following: (1) **equity** – the ability of each partner to effectively reach the target groups; (2) **demand** – the demand for services and resources from target group clients served by each partner; (3) **absorptive capacity** – the amount of resources each partner can effectively absorb and provide to the target groups; (4) **results achievement** – the contribution of each partner to the achievement of REACT Activity results and indicators; and (5) **accountability and transparency** – the proper and efficient management and use of resources by each partner.

Below is a description of illustrative sub-activities for the REACT Activity.

A. Expansion of Medium-Term Credit

The commercial banking system in Honduras has historically focused on the provision of short-term (i.e., working capital) credit, with few credit resources being directed toward the agriculture sector of the economy in general, and small and medium businesses and agricultural producers and processors in particular.

The already difficult credit situation was exacerbated by the damage or loss of productive infrastructure (e.g., vehicles, farm equipment, packing sheds, processing machinery) occasioned by Hurricane Mitch. In order for the Honduran economy to be reactivated, small and medium producers, processors and businesses will require increased access to medium-term credit resources to repair or replace productive infrastructure, thereby restoring or even increasing pre-Hurricane Mitch production levels.

To address the medium-term credit constraint, it is anticipated that activities under the REACT Activity will be implemented through USAID-direct contracts, grants and/or cooperative agreements with financial intermediary NGOs that would provide financial and business services and credit resources to those members of the target groups most affected by Hurricane Mitch. In this way, the REACT Activity proposes to expand the availability of medium-term credit for small and medium businesses and agricultural producers and processors. Because of the different needs of the target groups, it is anticipated that at least two NGOs will receive funding for this sub-activity: (i) one to reach small and medium rural businesses and agricultural cooperative members; and (ii) one to provide assistance to agricultural cooperatives and small to medium agricultural producers.

B. Recovery and Reactivation of Small and Micro-enterprise

The recovery and reactivation of small and micro-enterprise will be achieved through assistance to organizations that assist micro-enterprise businesses. It is expected that activities under this sub-activity will be implemented through NGOs capable of providing assistance to entrepreneurs which heretofore operated outside of the formal economy, either through individual contracts, grants or cooperative agreements with one or more such organizations or under an "umbrella" arrangement or both. Credit resources and business services will be directed to small and micro-entrepreneur beneficiaries in rural areas within the sphere of influence of key geographic cities (e.g. La Ceiba, Choluteca, Danli, and Comayagua) and other areas damaged by Hurricane Mitch. Subject to compliance with all applicable restrictions, including those set forth under Section III.E below, eligible loans will include production, processing and marketing ventures in the widest possible array of fields (e.g. agribusiness, light manufacturing, and social services). It is anticipated that approximately 20% of the clients will be first-time borrowers. Emphasis throughout will be on financial sustainability while providing access to credit to a poor segment of the society.

On the basis of successful proposals, the NGO selected will provide credit and financial services directly, and/or through participating "second-tier" NGOs, to the target group participants. Disbursements from the selected NGO to the participating NGOs are expected to be provided in increments. As an initial disbursement, the selected NGO will release to participating second-tier NGOs, for on-lending to the ultimate borrowers, an agreed upon percentage of the approved grant total. The balance will be assigned as a liability to each NGO against portfolio management performance. If the portfolio is administered in accordance with agreed upon criteria, and in a manner satisfactory to the selected NGO and USAID, subsequent tranches of the outstanding balance will be passed to each NGO for on-lending.

C. Recovery and Reactivation of Small and Medium Farms

Activities under this sub-activity will form an integrated program to bring about significantly increased production of traditional and non-traditional agricultural products for local, regional and international markets, including training and technical assistance programs to rehabilitate and increase production of selected, high priority agricultural commodities which suffered extensive damage during Mitch.

Specialized NGOs, under separate contracts, grants or cooperative agreements, will (1) assist small and medium growers in the production and marketing of agricultural products; (2) conduct market research and promotion for selected crops; and (3) provide technical assistance, training and agricultural technology transfer in agricultural production and processing to small and medium farmers. Subject to compliance with applicable restrictions including those set forth below under Section III.E, crops which may be considered include: plantains and organic bananas, selected warm and temperate climate vegetables, tropical roots and tubers and soft fruits (strawberries, raspberries and black berries), coffee, beans, and dairy products. In addition, REACT Activity funds may be used to provide participating NGOs and target group beneficiaries with specialized technical assistance in the areas of rehabilitation of plant and animal disease diagnostic laboratories, documentation of pest and disease free areas, integrated pest management, and food safety problems related to the processing and marketing of milk and milk products.

D. Policies in Place to Promote Economic Reactivation

To sustain economic recovery from the devastation caused by the Hurricane "Mitch" and to recapture pre-Mitch rates of economic growth, Honduras will require massive private and public sector investment and adherence to economic policies that foster investment in agriculture, mining, tourism and the *maquila* industry.

REACT Activity resources will be used to intensify technical assistance in the policy area through appropriate organizations which might include one or more of the following: UNAT, the Honduran Chambers of Commerce (FEDECAMARAS), Honduran National Congress (HNC), Honduran Central Bank, the Ministry of Finance, SENASA and other institutions. Any REACT Activity assistance provided to the above organizations will be based on mutually agreed upon work plans and budgets. An illustrative list of policy areas that the REACT Activity is expected to focus on includes the following:

- Maintain an economic policy framework conducive to: 1) the recovery of small and medium enterprises and agricultural producers, 2) the creation of employment opportunities, and 3) acceleration in the repair and replacement of critical infrastructure.
- Support financial sector policies that will: 1) enable the refinancing of existing debts of businesses and facilitate new loans; 2) improve access to savings and credit by micro and small businesses and farmers; and 3) promote reforms of the financial sector to encourage further expansion of these services.
- Create new incentives for private investment. For example, broaden and clarify land use options and provide land security for investors, create a viable land market, and develop and approve a chattel mortgage law and comprehensive water use law.

An illustrative list of activities to be undertaken using REACT Activity funds are:

Assistance to UNAT: UNAT is a specialized technical unit that provides support to the GOH's Reconstruction Cabinet and is responsible for the coordination of diverse tasks related to the

implementation of the GOH's Master Plan for Reconstruction and Transformation (MPRT). USAID has provided financial and technical assistance to the UNAT in the development of the MPRT. The GOH has requested that USAID continue to provide this assistance in order to further reconstruction efforts and to implement policy reform to build a more transparent economy.

Assistance to Honduran Congress: USAID has provided technical assistance and training under a current program concerning the effect of free markets on the allocation of scarce production resources and the benefits of well-targeted subsidies to assist the poor in a cost-effective manner. REACT Activity resources are expected to be used to enhance this program with the Honduran National Congress. The primary objective will be to better inform legislators on efficient and effective policies and programs that provide producer incentives to invest more and become more productive.

Assistance to the Chambers of Commerce (FEDECAMARAS): Assistance may be provided to FEDECAMARAS to assist this organization in its efforts to reach small and medium enterprises, providing them market information to develop inter-enterprise linkages among different cities in Honduras and overseas. Resources under the REACT Activity may be used to assist small micro-enterprises (SMEs) affected by Mitch to rehabilitate their productive activities. This program is expected to provide these firms with greater information on where to obtain technical and financial assistance to rebuild their production plants, increase their production through greater productivity, and expand their markets. These firms will help identify policy and regulatory issues that constrain the growth of the SMEs in the secondary cities. This program will have the additional benefit of strengthening local Chambers of Commerce and Industry, so that SMEs can continue to grow, thereby providing more employment and greater revenue to municipal governments for necessary local public services.

Assistance to the Central Bank: In order to have more accurate data to measure and monitor the impact of donor funds going for reconstruction, the Central Bank of Honduras (CBH) will require assistance. The CBH is proposing to improve its system of collection and processing data used in estimating the economy's GDP, particularly for sectoral private and public investment. Resources under the REACT Activity may be used to provide financial and technical resources to the CBH to support this effort.

Assistance to the Ministry of Finance: REACT Activity funds may be used to finance Hurricane Mitch reconstruction-related technical and other assistance to the Ministry of Finance.

The proposed policy and program interventions should provide important contributions to the broad-based economic reactivation of the Honduran economy. REACT Activity assistance may be used to assist the Grantee to develop and implement policies and programs that encourage greater production, well-targeted subsidies, effective disaster mitigation, decentralization, and transparent government reconstruction programs.

The above activities will provide financial and technical assistance to key public and private institutions to enable them to formulate and implement appropriate policies and programs and to monitor and adjust them as necessary.

E. Restrictions on Agricultural Development and Investment Promotion Activities

Except as USAID shall otherwise agree in writing, the following restrictions apply to any and all funds provided by USAID under the terms of this Agreement to (i) the Grantee or any ministry or institution thereof; (ii) any contractor or grantee under any contract or grant/cooperative agreement executed pursuant to the terms of this Agreement; and (iii) any subcontractor or subgrantee/recipient of any of the foregoing:

1. In no event shall any of such funds be used for agricultural development activities (that is, any testing or breeding feasibility study, variety improvement or introduction, consultancy, publication, conference, or training) in connection with the growth or production in Honduras of an agricultural commodity for export if such commodity would compete with a similar commodity grown or produced in the United States unless the activities are designed to increase food security in Honduras and USAID determines, on a case-by-case basis, that the commodity involved and such activities will not have a significant impact on the export of agricultural commodities of the United States.
2. None of such funds shall be used to finance any loan or provide any other assistance for establishing or expanding production of any commodity for export from Honduras if the commodity is likely to be in surplus on world markets and substantial injury will be caused to U.S. producers of the same, similar or competing commodities. In addition, unless USAID shall otherwise agree in writing, none of such funds shall be used to provide loans and/or assistance involving the production, processing or marketing of sugar, palm oil or citrus for export.
3. None of such funds may be used for loans or assistance for establishing or developing export processing zones or for certain investment promotion activities as set forth in Section F.1 of the Standard Provisions included in Annex II to the Agreement.

IV. Roles and Responsibilities

1. *Government of Honduras:* The GOH will have a specifically defined role in the implementation of the credit and policy portions of the REACT Activity and will be called upon to make several important, facilitative interventions. The GOH will assist with passage of legislation enhancing the role of local NGOs in financial intermediation, especially as it relates to small and micro-enterprises. The GOH, through UNAT, the Central Bank, the Ministry of Agriculture and Livestock, and the Congress, will also be an active partner in addressing a wide range of economic reactivation issues.
2. *Private Sector:* It is anticipated that most activities under the REACT Activity will be implemented through local and/or international NGOs through USAID-direct assistance instruments.
3. *USAID:* USAID's *Economic Activity Reactivated* Strategic Objective (SO) Team will monitor activities and progress for the REACT Activity. Members of this SO Team will be designated by the SO Team Leader to manage the REACT Activity under this Agreement.

USAID may enter into cooperative agreements, grants, contracts or memoranda of understanding (MOUs) directly with implementing NGOs, agencies or firms using funds provided under this Agreement in order to procure the technical assistance, goods, training and other services required to achieve the Results contemplated for the REACT Activity under this Agreement.

4. *Results Teams:* Two Results Teams will have responsibility for monitoring activities and related resource utilization under the REACT Activity. The primary role of each Results Team will be to ensure complementarity among activities and efficient use of resources. In addition, Results Teams will seek to maximize the synergies between the sub-activities. This will be achieved through joint meetings to review and discuss progress in meeting results.

The composition of these Results Teams will be agreed to by the GOH and USAID through the issuance of a joint Implementation Letter. However, it is anticipated that both Results Teams will include representatives from the lead private sector NGOs, one representative each from the Ministry of Finance, SETCO, and the Ministry of Agriculture and Livestock, and the SO Team Leader and USAID activity manager(s). The Results Team for credit activities may also include representatives from the Honduran Association of Banking Institutions (AHIBA) and the National Fund for Production and Housing (FONAPROVI).

V. Monitoring, Reporting, Evaluation and Audits

A. Monitoring Results, Indicators and Targets

The specific results, indicators and targets for the REACT Activity are set forth in Section III of Annex I to the Agreement.

B. Activity Monitoring, Performance Evaluation and Reporting

Each contract, grant agreement and cooperative agreement executed with funds provided under the REACT Activity will contain provisions setting forth the requirements for monitoring, performance and reporting. In general, each contractor/grantee will be required to submit for review to USAID an annual workplan and budget at the beginning of such contractor/grantee's implementation year. This annual workplan and budget, together with an activity report for the previous year, will be required prior to disbursement of funds for each subsequent year. Each contractor/grantee will also be required to submit (i) quarterly progress reports detailing the status of activities, problems encountered/issues identified and proposed corrective action and (ii) a final report which includes an overall description of activities performed, methods of work used, major accomplishments and problems encountered and comments and recommendations regarding unfinished work and/or program continuation and direction, as well as a fiscal report that describes how USAID grant and counterpart funds were used.

C. Evaluations

All of the subactivities under the REACT Activity will be subject to independent evaluations, both as discrete interventions and as part of the REACT Activity. Each contract, grant

agreement and cooperative agreement is expected to include a set of indicators on which the individual evaluations will be based. USAID may contract independently to procure the required evaluation services.

D. Audits

Each contract, grant agreement and cooperative agreement will contain provisions setting forth the requirements for audits. Such requirements, as well as the arrangements with Grantee ministries and institutions, will be consistent with Section B.5 of the Standard Provisions Annex II to the Agreement.

VI. Illustrative Financial Plan

The illustrative financial plan for the REACT Activity is included as part of the illustrative financial plan for this Agreement as described in Section VII of Annex I to the Agreement.